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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1940

UNION TRUST COMPANY OF INDIANAPOLIS AS
FORMER EXECUTOR OF THE LAST WILL AND TESTA-
MENT OF WILLIAM H. BLOCK, DECEASED, PETI-
TIONER,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE.

No. 105

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR
THE SEVENTH CIRCUIT

PETITIONER'S REPLY BRIEF

I.

THE REFUND OF FEDERAL ESTATE TAX WAS NOT
TAXABLE INCOME

It is not contended that a refund of federal estate tax
is *per se* income. To make it such, reliance is placed upon

the fact that the amount was deductible in computing *taxable* income of the years in which paid. That, except for Congressional favor, it was not properly an item in the computation of net income, is evidenced by the fact that such deductions are no longer allowable, on the ground that estate tax is a capital levy having no relation to the earning of income. (House Committee on Ways and Means, Report No. 704, Revenue Bill of 1934, page 22.)

That every restoration of a prior expenditure is not "income" is recognized in cases cited by the Respondent. Thus, in *Wichita State Bank & T. Co. v. Commissioner*, 69 F. (2d) 595 (C. C. A. 5th), certiorari denied 293 U. S. 562, the bank was taxed upon the partial restoration of assessments to defray current losses chargeable to a state deposit guaranty fund, but not upon restoration of its contributions to the permanent fund.

The former was restoration of an expense of doing business to earn income. The latter was a restoration of capital.

In *Cooper v. United States*, 9 F. (2d) 216, 224, (C. C. A. 8th), the Court recognized that insurance replacing a previous inventory loss was not "income" in the strict sense, but was taxable because the inventory loss had previously entered into computation of profits and its restoration likewise should enter into a determination of "excess profits."

In *Houbigant, Inc. v. Commissioner*, 31 B. T. A. 954, affirmed 80 F. (2d) 1012 (C. C. A. 2d), certiorari denied 298 U. S. 669, *Commissioner v. Central United National Bank*, 99 F. (2d) 568 (C. C. A. 6th), and *Victoria Paper*

Mills Co. v. Commissioner, 32 B. T. A. 666, affirmed 83 F. (2d) 1022 (C. C. A. 2d) the taxes refunded, and in *Automobile Ins. Co. v. Commissioner*, 72 F. (2d) 265 (C. C. A. 2d), the insurance payments restored, represented restoration of prior business expenses, attendant upon the earning of income in prior years, and, as in *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, could properly be classified as deferred income.

Similarly, the property loss restored in *Marine Transport Co. v. Commissioner*, 77 F. (2d) 177 (C. C. A. 5th), had resulted from a risk attendant upon the enterprise (sinking of ship while on voyage) and had been a deductible business expense of earning income.

In *Universal, Inc. v. Commissioner*, 109 F. (2d) 616 (C. C. A. 7th), the refunded excise taxes collected from customers and paid to the United States, without ever having entered into the taxpayer's returns, obviously were business receipts and were a clear business gain when restored at a time when all obligation to refund to the customers had ceased.

The bad debt cases, *Askin & Marine Co. v. Commissioner*, 66 F. (2d) 776 (C. C. A. 2d), *Commissioner v. Liberty Bank & Trust Co.*, 59 F. (2d) 320 (C. C. A. 6th), and *Carr v. Commissioner*, 28 F. (2d) 551 (C. C. A. 5th), are also clearly distinguishable from the instant case, in that it has always been a condition of deductibility that any recovery should be returned as income when received. This is the major ground of decision in *Commissioner v. Liberty Bank & Trust Co.*, 59 F. (2d) 320, 325. No such condition attached to deduction of the tax payments now in question.

It is therefore submitted that a refund of federal estate tax cannot be taxed as income except on the basis of an equitable estoppel arising from its prior deduction from taxable income, and that in this case the facts do not support such an estoppel.

Respondent attempts to harmonize the cases of *Inland Products Co. v. Blair*, 31 F. (2d) 867 (C. C. A. 4th) and *Leach v. Commissioner*, 50 F. (2d) 371 (C. C. A. 1st) upon the theory that in those cases prior years were still open. Respondent's brief (p. 8) stresses the fact that here assessments for 1930 and 1931 were barred "before the petition in the present case was filed with the Board."

Since there was no right or opportunity to file "the petition in the present case" until the Commissioner served notice of deficiency, this argument in effect asserts that the taxpayer is estopped by the Commissioner's own delay in assessing the alleged deficiency in controversy. The deficiency notice giving rise to the "petition in the present case," was not served until March 13, 1935, when limitations had run on all prior years in controversy. (R., 3, 13.) It was the neglect of the Commissioner, after full knowledge, which resulted in limitations having run "before the petition in the present case was filed with the Board." Respondent thus seeks to found an estoppel against petitioner upon his own delay and laches.

The taxpayer was under no legal duty to file amended returns, and we submit that under the circumstances here presented there was no moral duty. The audit of the 1929 return not only disclosed all circumstances, but called specific attention to the (supposed) fact that the taxpayer

would not be required to include the refund as income when received. (R., 69-70.) There was certainly more reason to believe that whatever adjustment was required in the 1929, 1930, and 1931 returns would be made in time than that a deficiency, then disclaimed, would be asserted for 1932.

To recognize an estoppel under such circumstances has the effect of giving to the Commissioner of Internal Revenue an election as to what years shall be made to bear the burden of adjustments consequent upon subsequent alteration of a taxpayer's accounts. We submit that the matter is one to be settled by rules of law and not arbitrary administrative fiat. Liability on account of deductions proved improper by subsequent unforeseen circumstances should not be imposed in either of two years at the whim of the Commissioner.

II.

THE DEDUCTIBILITY OF INCOME PAYMENTS TO BENEFICIARIES

Respondent has fairly stated the decisions in *Burnet v. Whitehouse*, 283 U. S. 148, and *Helvering v. Butterworth*, 290 U. S. 365, but has not, we submit, correctly applied them to the instant case. It is stated that:

“Under this testamentary scheme, it is clear that the annuities were not dependent upon the realization of income, but were payable in any event and, if necessary, the payments were to be a charge upon the corpus.”

This, we submit, is inaccurate. Absent income, the annuities were not payable in "any event," but only in the events that (a) a willing lender (not purchaser) could be found, and that (b) there appeared such a reasonable prospect of future income sufficient to discharge the loan that the fiduciaries would be justified in exercising a power to make loans which prescribed this method of discharge. This is far from being an annuity payable at *all* events.

We do not contend that the direction to discharge loans from future income makes the conditional bequest of borrowed money payable from income. We do contend that such a direction limits the power to borrow as well as the probability of its effective exercise in such manner as to negative the construction that the annuities are payable at *all events and from corpus*.

The case of *Duncan v. Commissioner*, 34 B. T. A. 999, affirmed 91 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 302 U. S. 752, relied upon by Respondent, is not in point or even controlling, since in default of income the gifts were absolutely payable from corpus (not from funds whose availability depended on finding a lender), and the direction to restore corpus from income did not in any manner limit the absolute power and duty to pay from corpus. Here, we submit, the trustees are not authorized to borrow unless a reasonable probability of sufficient future income is apparent.

Here, there are in effect two gifts, an absolute gift of income, and a conditional gift of borrowed funds. The condition of the second gift has never happened and it

should not, therefore, affect the incidence of tax with respect to the first gift.

Respectfully submitted,

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